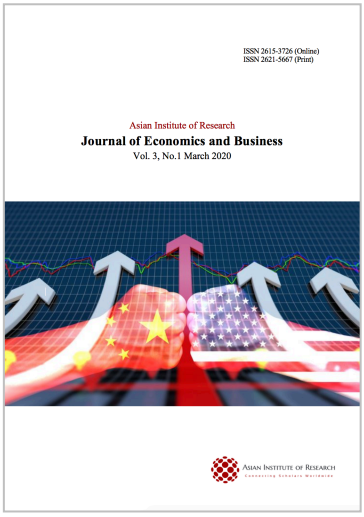

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Analysis of the Effect of Business Strategy and Financial Distress on Tax Avoidance

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Abstract
In recent years, tax avoidance has been frequently discussed and has attracted the attention of the Indonesian government. Many factors affect tax avoidance, one of it is business strategy. Not only business strategies, but also financial distress can also be one of the factors causing tax avoidance. Related to the problem, in this study we would examine the impact of business strategies and financial distress of Indonesian companies to tax avoidance practices. The samples of this research were 292 companies in the manufacturing, trade and construction sectors which were listed on the Indonesia Stock Exchange in period 2015-2018 and obtained 1168 research data. This research used multiple linear regression method. Our regression results proved that the prospector business strategy has a positive impact on tax avoidance, while the defender's business strategy has a negative impact on tax avoidance. Meanwhile, related to financial distress, our results showed that financial distress has a positive impact on tax avoidance.

Keywords: Business Strategy, Corporate Tax Avoidance, Defender, Financial Distress, Prospector

1. Introduction

Tax is one of the biggest income for a country, so tax becomes an object that is highly considered by the government in its fulfillment. Tax has the characteristics as a mandatory contribution of society, where one of the parties who have the obligation to pay taxes is the company whose amount is calculated from the net profit obtained, so if the obtained profit is great, the tax which is paid will be great as well. However, many taxpayers assume that tax payment is a burden, so most people have a tendency to avoid, even they choose not to pay taxes when the opportunity arises. According to Putri and Chariri (2017) generally, tax avoidance is associated with tax planning. Tax planning is a process of taxpayers to minimize their tax debt, whether it is income tax or other tax burden payable.

Before starting a business, a company needs a business strategy that is usually made by managers, where this business strategy affects all company activities (Arieftiara, Utama, Wardhani, & Rahayu, 2015). Business

strategies can make business processes more effective, and make the company more superior than its competitors. Based on research of Miles, Snow, Meyer, & Coleman (1978) there are four types of business strategies of a company, namely: defender, prospector, analyzer, and reactor. In Business strategy doesn't focus on widening the market, launching new products, giving discounts and other similar things only, but also doing a variety of ways to survive. One of the actions that is often taken is to increase revenue or reduce existing expenses, including tax expenses. According to Dhamara and Violita (2018), to reduce the amount of tax paid, companies tend to reduce their pre-tax income through various tax planning strategies.

Besides business strategies, financial distress can also trigger companies to avoid tax. Companies that are in financial distress increase tax aggressiveness to generate additional cash outflows (Richardson, Lanis, & Taylor, 2014). Nugroho and Firmansyah (2017) in their research gave a real example when there is an economic crisis in Indonesia found that many companies experience financial distress or high financial distress so that they are no longer able to maintain the company's survival due to continuous losses, have very large debts and lack of cash to pay off the debt. In the condition of financial distress, companies are required to save capital or meet the minimum capital needed by the company, so that the company is still able to maintain credit ratings, meet the requirements of debt agreements, or continue as a going concern company (Richardson, Taylor, and Lanis, 2015). These demands encourage companies to avoid tax in order to maintain company profits.

Tax avoidance aggressively by companies is not necessarily in line with the wishes of shareholders, which means there is a mismatch between the wishes of shareholders with management behavior that is usually known as agency theory. A company will implement a strategy in accordance with the market conditions that is faced. The business strategy adopted by the company is influenced by decisions taken by the leader. Companies that use different business strategies will face different conditions in the future as well. Therefore, there are companies that are experiencing financial distress due to changes in the implementation of business strategies in their companies. In this contingency theory, the role of the leader is very necessary to understand the conditions being faced by the company and how to overcome the problems that arised.

2. Literature Review

Higgins, Omer and Phillips's research (2011, 2015) examined the relationship between corporate business strategy and tax planning, first, they examined whether business strategy influenced tax avoidance. This research is important to help a better understanding of the factors that influence the tendency of companies to engage in aggressive tax avoidance. This study also uses the typology of Miles and Snow (1987) about business strategy. Higgins found that the prospector did higher tax avoidance than the defender as seen from the lower book and cash ETR and higher permanent book-tax differences. Similar to the research conducted by Martinez and Ferreira (2019), they analyzed the relationship between the types of corporate business strategies and tax aggressiveness with a sample of companies in Brazil. Martinez's research also uses the typology of Miles and Snow (1987) and excludes two strategies namely, analyzer because it is a combination of defender with prospector, and reactors that are considered unstrategic. Different from the study of Higgins et al. (2015), Martinez & Ferreira's research (2019) found that defender companies also have a tendency to be more tax aggressive or take higher tax risk. Wahyuni et al. (2017) also mentioned in their research that business strategy has a significant positive impact on tax avoidance.

In addition to business strategies, research conducted by Richardson et al. (2014) shows that financial distress has a positive impact on tax avoidance practices. Richardson et al. (2014) said that when companies are in financial distress, the benefits of tax avoidance are bigger than the cost savings thereby increasing incentives to avoid taxes. In addition Richardson also believes that financial distress increases incentives for risk reduction behaviors that occur by shareholders and their agents. In the event of financial distress, the strategy previously seen by the company has a high or expensive risk to do, which can be more attractive and feasible as the potential benefits of tax avoidance increase (Richardson et al., 2015). But the results of the study contradict the opinion of Putri and Chariri (2017) which stated that financial distress has a negative impact on tax avoidance practices. Meanwhile, according to Dhamara and Violeta's research (2018) which also examines the impact of financial distress on tax aggressiveness, this study uses a sample of manufacturing companies in Indonesia.

Violita and Dhamara's research results contrast with the research of Richardson et al. (2014), which stated that financial distress does not have a significant impact on tax aggressiveness. This is due to the fact that this research does not cover periods of financial crisis which can increase the chances of financial distress.

This study is different from previous studies because this study combines how business strategy, as well as financial distress, can affect the corporate tax avoidance. This research was conducted on companies which were listed on the Indonesia Stock Exchange in 2015-2018, especially in the manufacturing, trade and construction sectors because these sectors are large sectors and provide a significant contribution to economic growth in Indonesia and also to state revenue in terms of taxation.

2.1 Hypothesis Development

Business strategies have an impact on corporate tax avoidance behavior depending on how the characteristics of each strategic type affect the costs and benefits of tax planning (Higgins et al., 2015). Dunbar and Phillips (2001) argued that prospectors are less in focus on minimizing income tax costs, and thus will outsource more of their tax planning and compliance activities. On the one hand, Higgins et al. (2011) states that Miles and Snow's topologies (1978) showed the potential benefits of tax avoidance are greater for defender companies than for prospector companies because defender companies emphasize cost efficiency as a basis for competitive advantage while prospectors focus more on innovation and growth and less on cost minimization. In particular, defenders are more likely to avoid the risks and uncertainties associated with taking an aggressive tax position. Or, the prospector embraces risk and is better equipped to deal with uncertainties that result from an aggressive tax avoidance strategy. So the researchers formulated the research hypothesis as follows:

H1: Companies with a Prospector strategy are more aggressive in tax avoidance

H2: Companies with a Defender strategy are less aggressive in tax avoidance

When running a business with any strategy, it certainly does not always run smoothly. Many obstacles may be able to hamper the company's growth, one of it is the condition of financial distress. Under these conditions, the company is required to maintain its status as a going concern company. This is what encourages companies to avoid tax in order to maintain company profits because the company considers that tax is a significant cost and cash flow out is significant enough to reduce company profits. Therefore, researchers formulate research with the following hypothesis:

H3: Financial distress has a positive impact on tax avoidance

3. Research Method

3.1 Sample

The determination of the sample in this study came from companies that listed in the manufacturing, trade and construction sectors that are listed on the Indonesia Stock Exchange. This study used a purposive sampling method with criteria according to table 3.1.

Table 3.1 Sample Selection Output

Sample Criteria	Amount	Unit
All companies listed on the Indonesia Stock Exchange 2015-2018	326	Company
Manufacturing, trading and construction companies that publish financial statements for the period 2015 to 2018 using the Rupiah currency.	(20)	Company
Companies that do not have complete variables for research	(14)	Company

Amount of data used as research objects	(292/ 1168)	Company / Data

3.2 Variables Operationalization

This study used business strategy as an independent variable. The independent variable is an independent variable that affects the dependent variable. As measured using six indexes according to Bentley et al. (2013). The six indexes are:

1. Ratio of research and development to sales,
2. Ratio of employees to sales,
3. A measure of historical growth (one-year percentage change in total of sales),
4. The ratio of marketing to sales,
5. Employee fluctuation (standard deviation of total employees), and
6. Capital intensity (net PPE measured by total assets).

In addition to business strategy, financial distress in this study is also used as an independent variable measured using the Altman Z Score (Altman & Hotchkiss, 2006), as follows:

Z Score = 1,2A + 1,4B + 3,3C + 0,6 D + 0,99E
Explanation:
A = working capital divided by total assets
B = retained earnings divided by total assets
C = income before interest and tax expense divided by total assets
D = market value equity divided by book value of total debt
E = sales divided by total assets

From the formula above, companies that have a Z score> 2.99 are classified as companies in the safe zone, companies that have a Z score between 1.81 and 2.99 are classified as companies in the gray zone, and companies that have a Z score of <2.99 are classified in the distress zone that has the potential for bankrupt.

The dependent variable used in this study is tax avoidance. Tax avoidance is measured using a cash effective tax rate (CETR), where CETR as paid tax cash is divided by book income before tax. CETR identifies all tax avoidance activities that reduce tax cash, which is paid to the government (Higgins et al., 2011). The following formula for calculating CETR:

Cash ETR = $\frac{Cash\ Tax\ Paid\ i,t}{Pretax\ Income\ i,t}$ i = company ; t = year

Control variables are variables that are constantly controlled so that the relationship between the independent variable and the dependent variable is not affected by external factors that are not the object of research. The control variables in this study are as follows:

1. Firm Size
   Company size is used because larger companies tend to pay higher political costs, including income taxes and often participate in tax planning (Dhamara and Violita, 2018). Firm size is measured using the natural log of total assets in year t.
2. Leverage
   Interest costs arising from debt is a reduction in gross income, higher interest costs will have the impact on reducing the company's tax burden (Wahyuni et al., 2017) which has a positive effect and becomes an incentive for a company to carry out tax planning (Cheng, Huang, Li & Stanfield, 2012). Leverage is measured using long-term debt divided by total assets.
3. Return On Asset (ROA)
   Company profitability is the company's ability to generate profits which can cause the amount of tax to change from year to year. Companies that have higher profitability also tend to have higher effective tax rates (Dhamara and Violita, 2018). ROA is measured using net income divided by total assets.
4. Capital Intensity

Capital intensity is how big the proportion of fixed assets in the total assets owned. Increasing the company's fixed assets will increase company productivity and company revenue. High ownership of fixed assets will result in high depreciation costs, so the company's tax burden will be reduced (Maulana, Marwa & Wahyudi, 2018). Capital intensity is measured using net PPE divided by total assets.

5. Sales Growth
   Sales growth shows development of growth rate from year to year (Wahyuni et al., 2017). The greater sales volume of a company shows that the company's sales growth is increasing. If sales growth increases, the profits generated by the company are assumed to increase. Sales growth is measured using the final sales period minus the initial sales period divided by the initial sales period.
6. Firm Age
   Controlling differences in the length of time a company's stock has been traded on the public market (Richardson et al., 2015). Firm age is measured using the age of the company in the year since the company had been founded. From the age of the company can be seen the difference in the experience of a company in reducing tax costs.

3.3 The Model of Analysis

The analytical model used in this study is multiple linear regression. To test the hypothesis of the relationship between business strategy and financial distress against tax avoidance, it will be formulated as follows:

$$CETR = -5.141 + 0.338PROS - 0.171DEF + 0.162FDISTRESS - 0.004SIZE – 0.269LEV + 0.052ROA + 0.036CAPINT - 0.009GROWTH +3.403AGE + \varepsilon$$

Explanation:

CETR	= cash effective tax rate (CETR), where CETR as paid cash of tax is divided by book income before tax
PROS	= The prospector business strategy uses six indexes according to Bentley et al. (2013)
DEF	= defender business strategy, using six indexes according to Bentley et al. (2013)
FDISTRESS	= uses the Altman Z Score
SIZE	= natural log of total assets in year t
LEV	= long-term debt divided by total assets
ROA	= net income is divided by total assets
CAPINT	= net PPE is divided by total assets
GROWTH	= the final sales period is reduced by the initial sales period divided by the initial sales period
AGE	= the age of the company in years since the company was founded
Ɛ	= error

4. Result and Discussion

Testing data for this study used a model feasibility test, which included the coefficient of determination test (R^2), simultaneous test (F test), and partial test (T test). Model feasibility test is a test conducted whether the model used to do the regression is correct or incorrect.

4.1 Coefficient of Determination Test (R^2)

The coefficient of determination was used to see how much the independent variable explained the independent variable using the adjusted R^2 value as the value of the coefficient of determination which ranges from $0 < R^2 < 1$. If the adjusted R^2 value approached the number 1 (one), then the independent variable gives the information needed about the variable dependent. So it could be said that the greater the adjusted R^2 value, the independent variable is better able to explain the dependent variable well.

Table 4.1. Determination Coefficient Table

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics	
					R Square Change	F Change
1	.188	.035	.028	.85153	.035	4.693

Source: Author's Processed Results Based on SPSS Output

Based on the table, it can be seen that the value of R^2 or coefficient is 0.035. This shows that the independent variables together affect the dependent variable tax avoidance by 3.5% and the rest is explained by other variables not found in this study.

4.2 Simultaneous Test (F Test)

Simultaneous test is used to find out the significant regression coefficient together between the dependent variables namely tax avoidance, independent variables business strategy and financial distress. The results of the F test are as follows:

Table 4.2. Result of F Test

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	30.628	9	3.403	4.693	.000[b]
	Residual	83.676	1158	.725		
	Total	870.304	1167			

a. Dependent Variable: CETR

b. Predictors: (Constant), AGE, GROWTH, SIZE, PROS, DEF, FDISTRESS, CAPINT, LEV, ROA

Source: Author's Processed Results Based on SPSS Output

The regression model used shows the significance value of the F test is less than 5% (P <0.05). The regression model is declared feasible to be used to test the hypothesis because it has a significance of less than 0.05. When a regression model is feasible to use, the coefficient of determination (R^2) can be trusted.

4.3 Partial Test (T Test)

T test is used to show how far the influence of one explanatory variable or independent variable individually in explaining the variation of the dependent variable (Ghozali, 2006). The significance of the impact on the results of research in a test can be determined by looking at the significance of the T test, if the T test is smaller or equal to 0.05, it can be concluded that the independent variables and the control variables tested partially have a significant impact on tax avoidance, conversely if the significance results T test is greater than 0.05 then the independent variable partially does not have a significant impact on tax avoidance.

Table 4.3. Result of T Test

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-5.141	1.518		-3.386	.001*
	PROS	.338	.128	.076	2.633	.009*
	DEF	-.171	.045	-.111	-3.815	.000*
	FDISTRESS	.162	.070	.067	2.300	.022*
	SIZE	-.004	.005	-.023	-.782	.434
	LEV	-.269	.136	-.057	-1.974	.049*
	ROA	.052	.085	.018	.616	.538
	CAPTINT	.036	.092	.011	.393	.694
	GROWTH	-.009	.015	-.017	-.599	.549
	AGE	3.403	1.039	.095	3.275	.001*

Source: Author's Processed Results Based on SPSS Output
NOTES: **(*)** is a significance level less than 0.05 (95% confidence).

The results of T test value on the prospector business strategy variable is 2.633, with a significance level of 0.009, and show a regression coefficient of 0.388. The significance value of this T test has been smaller than 0.05 and the coefficient value is positive. Because the significance is below 0.05, it can be concluded that the prospector business strategy has a positive effect on tax avoidance. The result of this test proved that H1 is accepted, where an increase in the prospector business strategy will increase the level of tax avoidance. Prospector is a business strategy that tends to be active and flexible, where the prospector will try to enter new markets, new consumers, will adjust the intensity of production that follows the changes in consumer taste, and in this case the prospector will always do research. This is due to the focus that the prospector has on finding and maximizing the use of products, markets, and opportunities (Arieftiara et al., 2015). The cost of tax avoidance that must be borne by the prospector is not an obstacle for them, because the prospector gets high income from a broad market share and from the sale of his unique products that can adjust to changes in consumer tastes and trends, so they have few competitors. These are the strengths of the prospector business strategy, so that the cost of tax avoidance doesn't affect the survival of those companies. Therefore, companies with prospector business strategies are found to be aggressive towards tax avoidance.

The results of T test value on the defender business strategy variable is -3.815, with a significance level of 0.000, and shows a regression coefficient of -0.171. The significance value of this T test has been smaller than 0.05. Because the significance is below 0.05 and the coefficient value is negative. Therefore, it can be concluded that the defender business strategy has a negative effect on tax avoidance. The result of this test proved that H2 is accepted, where an increase in the defender business strategy will decrease the level of tax avoidance. Unlike the characteristics of the prospector, the defender tries to dominate the market by providing competitive prices to prevent other competitors from entering the market. Products issued by the defender do not focused on existing

trends, so the costs can be minimized. Tax avoidance activities are very beneficial for defenders because they can minimize the tax burden/tax costs (Arieftiara et al., 2015). Before doing the tax avoidance, certainly needed a plan dan large resources, so the costs are not small. Other than that, tax avoidance allows for tax penalties, tax interest, and risk of uncertainty. Defenders consider the costs more than the benefits of tax avoidance. The cost of tax avoidance will harm the price advantage in the defender's market, so the defender will prefer not to be aggressive in tax avoidance (Higgins et al., 2011).

For the financial distress variable is 2.300, with a significance level of 0.022, and shows a regression coefficient of 0.162. The significance value of this T test has been smaller than 0.05. Because the significance is below 0.05 and the coefficient value is positive, it can be concluded that financial distress has a positive effect on tax avoidance. The results of this test proved that H3 is accepted, where an increase in financial distress will increase the level of tax avoidance. According to Richardson et al. (2015) which also states that financial distress has a positive effect on tax avoidance. Companies that are in a state of financial distress will get more benefits in tax avoidance practices than reducing other company's costs, so the company has no choice than taking a higher risk and become more aggressive in taxation, because it's important for the company to increase their finances, since the tax expense becomes a significant cash outflow for companies in a depressed condition (Richardson et al., 2015). When a company is in a state of financial distress, a strategy that was previously seems risky and expensive, becomes more profitable for the company. Therefore, when the company is experiencing financial distress, the company will be more aggressive in tax avoidance

The results of the T Test for several control variables in this study indicates the value of Leverage (LEV) is 0.049 and Firm Age (AGE) is 0.001 where the value is less than 0.05 (95% confidence), so that Leverage and Firm Age have a significant effect on tax avoidance, where leverage shows a negative relationship with tax avoidance and Firm Age shows a positive relationship with tax avoidance. While the value of firm size (SIZE) is sealed at 0.434, Return on Assets (ROA) is 0.538, capital intensity (CAPINT) is 0.694, sales growth (GROWTH) is 0.549, which is greater than 0.05 so the above variable does not have a significant effect on tax avoidance.

Based on the results of the estimated regression coefficients in the table, the regression model is obtained as follows:

$$CETR = -5.141 + 0.338PROS - 0.171DEF + 0.162FDISTRESS - 0.004SIZE – 0.269LEV + 0.052ROA + 0.036CAPINT - 0.009GROWTH +3.403AGE + \varepsilon$$

5. Conclusion

We examine whether business strategies and financial distress has an impact on tax avoidance, where we use the research of Miles et al. (1978) to determine the business strategy under study (prospector and defender) and its measurement using the six indexes of Bentley et al. (2013), for financial distress we measure it with the Altman Z Score and tax avoidance is measured using Cash Effective Tax rate (CETR). So the results of this study indicate that:

1. The prospector business strategy has a positive impact on tax avoidance, which can also be interpreted as a prospector business strategy more aggressive in tax avoidance. So based on the results of the H1 test, it was concluded to be accepted.
2. The defender business strategy has a negative impact on tax avoidance, which can also be interpreted as a defender business strategy that is not more aggressive in tax avoidance. So based on the H2 test results it was concluded that it is accepted.
3. Financial distress has a positive impact on tax avoidance. So based on the results of the H3 test, it was concluded to be accepted.

This research is expected to provide an explanation of whether business strategy and financial distress have a significant effect on tax avoidance and is expected to provide information to companies in Indonesia to choose profitable and safe business strategies so it's not to lead to tax avoidance practices, even in their business activities experiencing financial distress.

Limitation in this study is the usage of formulas for measuring tax avoidance using CETR only. In future studies, it is expected to use several tax avoidance measurement formulas. In addition, we only use samples from the manufacturing, trade and construction sectors listed on the Indonesia Stock Exchange (IDX) in the 2015-2018 period. The next research is expected to pay more attention to the phenomena that are happening right now, especially in Indonesia in order to produce useful research for the readers.

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